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Supreme Court, U.S.
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IN THE
SUPREME COURT OF THE UNITED STATES

October, 1995 Term

JERRY L. SUMPTER
Petitioner
v.

UNITED STATES OF AMERICA
Respondent

Petition for Writ of Certiorari to the
United States Court of Appeals
for the Sixth Circuit

PETITION FOR WRIT OF CERTIORARI

Jerry L. Sumpter, J.D. P21164
Petitioner and
COUNSEL OF RECORD
P.O. Box 286
Cheboygan, MI 49721
(616) 627-7167
FAX: (616) 627-9675

85 pp

QUESTION PRESENTED FOR REVIEW

Did the Court of Appeals for the Sixth Circuit err when it expanded the language of §523(a)(1)(C) of the Bankruptcy Code to include the word "collection" or "payment" in defining conduct of a debtor sufficient to deny a Chapter 7 discharge.

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SC R 10 (.1)(a)(C) 1

STATEMENT OF THE GROUNDS ON WHICH THE JURISDICTION OF THIS COURT IS INVOKED

The order sought to be reviewed herein was entered August 22, 1995 by the United States Court of Appeals for the Sixth Circuit. (Appendix p1).

The Court of Appeals for the Sixth Circuit, in United States v Toti, 24 F. 3d 806 (6th Cir), cert. denied, 115 S. Ct. 482 (1994), has rendered a decision in conflict with In Re Haas, 48 F. 3rd 1153 (11th Cir. 1995), interpreting Section 523 (a)(1)(C) of the Bankruptcy Code, which conflict, because it involves the insertion by the Sixth Circuit into that Section of expansive language not intended by Congress, should be settled by this Court. (SC R 10 (.1)(a)(C)).

STATEMENT OF THE CASE

On September 27, 1989, Jerry and Santina Sumpter, husband and wife[1], filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. They sought discharge of various debts, including a debt to the Internal Revenue Service (I.R.S.) for unpaid taxes emanating from a disallowed deduction, interest, and penalties.[2]

In December of 1989, the Government brought a four count complaint against the Sumpters seeking:

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[1] As of April 28, 1995, the Sumpters are now divorced.

[2] A judgment for $60,000 (which has now grown to well in excess of $300,000) was entered pursuant to stipulation between the I.R.S. and the Sumpters, emanating primarily from tax years 1981 and 1982, wherein Mr. Sumpter made a book publishing investment that was contested by the I.R.S., which contest resulted in a tax change for both years. There was not then, nor has there ever been a claim of tax evasion: simply a disallowed deduction.

(1) a denial of discharge pursuant to Bankruptcy Code §§727(a)(4)(a)(2), and (a)(5) (Counts I - III), and (2) a determination pursuant to Bankruptcy Code §523(a)(1)(C) that their federal income tax liabilities are not dischargeable (Count IV). Cross motions for summary judgment were filed on all counts in September, 1990. On December 6, 1990, the Bankruptcy Court dismissed Count II against the Sumpters, and denied the I.R.S.'s motions for summary judgment against Santina Sumpter on all counts. However, the Court granted the I.R.S.'s motion on Count IV (§523(a)(1)(C)) against Jerry Sumpter, declaring that the I.R.S. debt was not dischargeable. In July, 1991, subsequent to the Bankruptcy Court's denial of his timely filed motion for reconsideration, Mr.

Sumpter filed notices of appeal in the District Court. [3]

The District Court affirmed the Bankruptcy Court: the Sumpters appealed in the United States Court of Appeals for the Sixth Circuit. On Appellants' motion, the cases were consolidated for briefing and submission. The Court of Appeals had jurisdiction by virtue of 28 USC § 158.

Background Information

In the late 1970's, the Sumpters created trusts naming their children as the sole beneficiaries. Three different trustees have served during the life of the trusts. The trusts have assets totalling over

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[3] Apparently, due to confusion as to whether his attorney had in fact filed a notice of appeal, appellant filed his own notice of appeal: (number 91-10231 was filed by attorney Donald Cadotte; number 91-10235 was filed by Jerry Sumpter, who is a licensed attorney).

$190,000.00.[4] The District Court said, page 3 of Memorandum Opinion that:

> "[t]he only explanation given as to how the trusts accumulated these assets was that the trusts own the building in which Mr. Sumpter's law firm or professional corporation ("P.C.") is located, and that the P.C. pays rent to the trust. (Tr 165)"

[In fact the trusts earned additional monies via other rents, loans, and interest, which income is fully and unimpeachably documented by the trusts' bank statements and tax returns, all of which were timely filed and all taxes thereon timely paid by the beneficiaries.[5]

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[4] Relying on the Sumpters' statement of Financial Condition, the Bankruptcy Court found that, as of 5/6/88, the value of the trust was $190,000.00.

[5]The Government will not likely contest the truth of this statement, and if they do, they are challenged to prove otherwise, from the record. See documents of record, which documents the government has had since the discovery stages of this

The District Court found that from the creation of the trust until the time of the trial in this matter, Mr. Sumpter's P.C. of which he owns virtually all of the stock,[6] received 12 loans from the trust totalling $257,900.00.[7] Each loan was short-term; each loan was fully documented, and each loan was repaid.

Further, all other trust monies are likewise documented and accounted for to the penny.

On August 25, 1986, the I.R.S. made an assessment for joint and

---

litigation).

[6]Mr. Perry is a minority stockholder in Sumpter & Perry, P.C.

[7]Later in the Court's opinion it found the trust "a conduit to loan the Sumpters money". The later language is a contradiction because if there were 12 loans that went to the P.C., then where is this conduit of money to the Sumpters? This finding too is contradicted by clear and unambiguous documents of Record.

several income tax liabilities against Mr. and Mrs. Sumpter for tax year 1985. Thereafter, additional assessments were made against the Sumpters: December 8, 1986, for tax year 1984, and on August 19, 1987, for tax years 1981 and 1982. By notice and demands dated the dates of each of the assessments, the Sumpters were notified of said assessments.[8]

The years 1986, 1987 and 1988 were significant loss years (over 1/4 million) for Sumpter & Perry, P.C., Mr. Sumpter's business. On **July 9, 1987**, Mr. and Mrs. Sumpter mortgaged the subject parcels of realty with First of America Bank, in return for a $40,000.00 line of credit.

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[8] Taxes then indicated as owing were paid with each return. Subsequently, the I.R.S. made its own adjustments, which precipitated a chain reaction.

Second notices of federal tax liabilities were sent by the I.R.S. on **December 21, 1987**, and **December 28, 1987**. (Tr 86) The first notices were in August 1987 and the second notices are well after the July 9, 1987 mortgage of the Sumpters' property to the First of America bank.

On January 11, 1988, a mortgage was given by the Sumpters to the Trust for their children, in return for a $90,000.00 loan to the P.C.[9] The borrowed monies went into and became operating capital for the P.C. The proceeds of this particular loan were used to pay-off the above referenced $40,000.00 mortgage to First of America, and other debts and operating expenses of the P.C.

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[9] One reason is obvious, because the bank would only loan $40,000 thereon.

Neither Mr. nor Mrs. Sumpter ever personally received any money from the trust. All trust checks for all loans from the Trust were fully documented and paid directly to the P.C. and directly deposited into the P.C.'s general account including the $90,000 loan. Within two days, the entire $90,000.00 was used to liquidate P.C. debt. On April 7, 1988, the I.R.S., return receipt requested, sent a final demand for payment to Mr. and Mrs. Sumpter.

On April 23, 1988, Mr. and Mrs. Sumpter transferred (deeded) the properties on which the January 11, 1988, $90,000.00 mortgage was given, to the trust, in return for a discharge of the mortgage debt. The trust agreement was recorded at Liber 490, Pages 426 through 429, Cheboygan County Records. The I.R.S. filed its notice

of federal tax lien on May 3, 1988. Mr. and Mrs. Sumpter filed their voluntary petition in bankruptcy on September 27, 1989.

The Court of Appeals for the Sixth Circuit affirmed as to Mr. Sumpter and reversed as to Santina Sumpter. (Appendix, p1)

ARGUMENT

The trial court granted the Government summary judgment against Mr. Sumpter on its motion under § 523 (a)(1)(C). In granting summary judgment the trial court relied solely on the transfer of the seven parcels of property to the trust.

In order to grant summary judgment the court had to find that Mr. Sumpter "willfully attempted in any manner to evade or defeat such tax." §523(a)(1)(C). In that regard the trial court relied exclusively on a single response to a complex question in Mr. Sumpter's deposition. The court apparently interpreted his answer as an admission that Mr. Sumpter's purpose in transferring the properties was to evade or defeat the tax. The trial court's interpretation of Mr. Sumpter's

admission is wrong in that it fails to consider the existence of an issue of material fact presented by the record as a whole.

The specific exchange relied upon by the trial court is as follows:

> Q. [by Mr. Clark for the government] Was the reason for transferring the properties to the trust to protect them from the Federal Tax liens?
>
> A. [by Mr. Sumpter] I think the real reason was to discharge the mortgage and to provide what equity we could to discharge the mortgage for fear that it would be -- a lien would be imposed against it and turn into a rats nest.
>
> Q. So that was -- well, was that something that you considered or thought of at the time that you were transferring the property and that is well, I could pay off this mortgage and in addition to that I could keep the liens from attaching to the properties?
>
> A. I couldn't pay off the mortgage. I had no money. The only way I could pay off the mortgage was with the equity in the property.

Q. The question is was one of the purposes or an additional purpose for transferring the properties to prevent the Federal Tax liens from attaching to the properties?

A. Yes.

The trial court's analysis is that the above exchange demonstrates Mr. Sumpter's intent to evade or defeat the tax. The problem with the Court's analysis is that it failed to distinguish an intent to avoid the attachment of the tax lien from an intent to evade or defeat the tax. The record establishes that Mr. Sumpter had no means of paying the $90,000 mortgage that attached to the realty in question in January 1988. The only method available for Mr. Sumpter to satisfy the mortgage was to convey the property

to the trust in satisfaction of the mortgage debt[10]. That is what Mr. Sumpter chose to do. Admittedly a small part of the reason he did this was to avoid the attachment of an I.R.S. tax lien.

However, an intent to avoid the attachment of the lien should not equate with an intention to evade or defeat the tax, unless Mr. Sumpter knew or believed there was value or equity in the property in excess of the amount due on the mortgage that he, by virtue of his actions, was keeping from the government.[11]

[10] It is axiomatic that there can be no fraud if consideration is adequate. The trial court specifically found that $90,000 was indeed paid and that payment constituted adequate consideration.

[11] Even this is an arguable strain on the statute language, i.e., with or without the attachment of the lien, the tax debt still exists. The tax debt itself was never evaded or defeated. It still exists today.

The mortgage was recorded with the Cheboygan County Register of Deeds on January 12, 1988. There is no discussion in the court's ruling that the mortgage itself shows an intent to evade or defeat the tax (nor indeed could there be as consideration was paid). The tax lien was filed four months later in May, 1988. The mortgage was a notorious prior lien and had to be satisfied before any value of the subject property would be available to the I.R.S. The record does not conclusively establish the value of that property. The maximum value for the property using the State Equalized Value (SEV) method was $97,000. The court itself questioned the use of that method. On Rehearing, other value calculations were presented. The point is, the court had no other evidence

before it as to the value of the mortgaged property. That is a question of fact[12].

Of course a question of fact must be a "material" question of fact before it precludes summary judgment. A material fact is one that will affect the outcome of the suit under governing law. See Anderson, 477 U.S. at 248. The value of the property, along with Mr. Sumpter's reasonable belief about its value, is material to the outcome of this action. If a forced sale of the property would not yield more than the amount of the mortgage, or if Mr. Sumpter reasonably believed that to be the case, he could have transferred the property to satisfy the mortgage,

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[12] Note again, however, that the trial court did find the consideration "adequate". Trial Court opinion at p13.

wholly intending to avoid the attachment of a tax lien, yet not intending to evade or defeat the tax.

The debtor could reasonably have believed the I.R.S. would receive nothing by attachment of its lien because a foreclosed I.R.S. lien on the property would not yield anything in excess of the first and second mortgages against the properties. The deed in satisfaction of the mortgage avoided the "rat's nest"; the lien would contaminate the legal title yet gain the I.R.S. nothing. If the value of the property did not exceed the mortgage, the I.R.S. lost nothing in the conveyance. Had the I.R.S. lien attached, the $90,000 mortgage and the other existing mortgages could have been foreclosed, which foreclosure would supersede the I.R.S. lien. The deed merely streamlined this process.

The error in the trial court's decision is that it assumes there was equity available to the I.R.S. In the absence of any such equity being proven at the time the motion was argued, or based upon Mr. Sumpter's reasonable belief in such an absence, his intent to avoid the attachment of the lien must not be equated to an intent to evade or defeat the tax. Mr. Sumpter's belief that there is no equity for the government is well founded.

In summary judgment, the judge's function is not himself to weigh the evidence and determine the truth of the matter, but to determine whether there is a genuine issue for trial. Id. at 249. The trial court here weighed the evidence and determined that the intent to avoid the lien proved intent to evade or defeat the tax. Implicit in

the court's determination is a finding of equity in the property available to the I.R.S., or that Mr. Sumpter reasonably believed such equity existed. Such a determination is inappropriate on summary judgment because it involves resolution of a question of fact.

In Vanguard Ins Co v Bolt, 204 Mich App 271, 276 (1994), the Court said:

> "The granting of a motion for summary disposition is especially suspect where motive and intent are at issue or where a witness or deponent's credibility is crucial. *Metropolitan Life Ins Co v Reist, 167 Mich App 112, 121; 421 NW2d 592 (1988); Crossley v Allstate Ins Co, 139 Mich App 464, 468; 362 NW2d 760 (1984).* Accordingly, where the truth of a material factual assertion of a moving party depends upon a deponent's credibility, there exists a genuine issue for the trier of fact and a motion for summary disposition should not be granted. See *Brown v Pointer, 390 Mich 346, 354;*

212 NW2d 201 (1973); Metropolitan Life, supra."

Secondly, Mr. Sumpter is an attorney with 24 years experience. He was not asked for his interpretation of §523 (a)(1)(C). If he testifies that, in his judgment, the word "collection" will not be read into the act (which interpretation is supported by In re Gathwright, infra,) then wilfulness is negated. Or if he researched the law and determined Gathwright, infra to be the law, then how could his action be wilful at that time.[13]

It is axiomatic that courts should avoid legislating. Where a statute is clear and unambiguous it should be interpreted as such. United States v

[13] Gathwright was the only law at that time. In Re Jones, 116 B.R. 810 (Bankr D. Kan. 1990) was a 1990 case discovered by the government after Mr. Sumpter's deposition.

James, 478 US 597, 92 L Ed 2d 483, 106 S Ct 3116 (1986). Section 523(a)(1)(C) does not contain the word "collection" anywhere therein and the word is noticeably absent from the congressional notes. How are laymen and lawyers alike to read §523(a)(1)(C) and conclude that the word "collection" is in there? Amazingly even with the word "collection" noticeably absent from §523(a)(1)(C), and the discussion thereunder[14], and the congressional minutes, the courts below want to insert it where it never was before, and then find the taxpayer "wilfully" violated the word that isn't there.

Finally, there is no claim or proof of any kind to the effect that the Sumpters ever concealed any assets, dealt in cash, failed to keep records,

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[14] USC 11 §523, p 146

or failed to file any tax return without all taxes paid therewith; thus there is no scheme here, evil or otherwise. The government is again challenged to show otherwise from the record. The entire tax debt here emanated simply from a disallowed deduction that grew beyond payment because of penalties and interest. The government cannot show a single hidden asset. Nor can the government show that the Sumpter's business was healthy to the extent that it didn't need to borrow money. The corporate tax returns and bank accounts in the government's possession clearly show the contrary, and the government is again challenged to show otherwise.

The trial court erred in granting summary judgment to the government against Mr. Sumpter.

In affirming the trial court's judgment against Mr. Sumpter, the Court of Appeals for the Sixth Circuit concluded that United States v Toti, 24 F3d 806 (6th Cir), cert denied, 115 S. Ct 482 (1994), " controls many aspects of this case." (Appendix p12) Construing Section 523(a)(1)(C) of the Bankruptcy Code, 11 USC § 523 (a)(1)(C), the Court found that the words "in any manner" encompassed attempts to thwart payment (emphasis added) of taxes. The Sixth Circuit, as did the trial court, chose to insert the word "collection" or "payment" into §523 (a)(1)(C), ignoring In Re Gathwright, 102 BR 211 (Bankr. D. Or, 1989), and the very recent In Re Haas, 48 F 3rd 1153 (11th Circuit, 1995).

The Sixth Circuit, in effect, has chosen to legislate beyond what

Congress intended Section 523 (a)(1)(C) to encompass.

In In Re Haas, the Court declared "[t]he sole question at issue . . . is whether a debtor's failure to pay his taxes, without more, constitutes a 'wilful [ ] attempt [ ] in any manner to evade or defeat such tax' under section 523 (a)(1)(C)." The government argued that the "plain meaning of the phrase 'wilfully attempted in any manner to evade or defeat such tax' . . . is sufficiently broad to invoke a debtor's 'voluntary, conscious and intentional' failure to pay taxes."

The Eleventh Circuit concluded in Haas that such an "interpretation of Section 523 (a)(1)(C) . . . would make all tax debts nondischargeable,"

thereby contravening the Bankruptcy Code's purpose.

The Haas Court went on:

> "Congress has on four other occasions previous to the enactment of section 523(a)(1)(C) shown itself capable of distinguishing between evasion of a tax and evasion of the payment of a tax." Id, 1515.
>
> . . . . .
>
> "Where Congress knows how to say something but chooses not to, its silence is controlling." Id, 1516. "
>
> " . . . Congress is presumed to be aware of pertinent, existing law when it passes legislation. *Miles v. Apex Marine Corp.*, 498 US 19, 30, 111 S. Ct. 317, 325, 112 L. Ed 2d 275 (1990); *Goodyear Atomic Corp v. Miller*, 486 U.S. 174, 184-85, 108 S. Ct. 1704, 1712, 100 L. Ed. 2d 158 (1988). This presumption is particularly strong in the case of I.R.C. §7201. Section 7201 is not an obscure provision; it is the principal enforcement provision of the I.R.C., " 'the capstone of a system of sanctions which singly or in combination were calculated to induce prompt and forthright fulfillment of

every duty under the income tax law and to provide a penalty suitable to every degree of delinquency.' " *Sansone v. United States,* 380 U.S. 343, 350-51, 85 S. Ct. 1004, 1010, 13 L. Ed. 2d 882 (1965) (quoting *Spies v. United States,* 317 U.S. 492, 497, 63 S. Ct. 364, 367, 87 L. Ed. 418 (1943)). As such, section 7201 was certainly pertinent to any bankruptcy provision intended to delineate which unpaid taxes would be dischargeable in bankruptcy and which would remain with the debtor. [footnote omitted].

"Therefore, we must presume that Congress was aware of both the language and the judicial interpretation of section 7201 when it drafted section 523(a)(1)(C). *Jordan,* 915 F. 2d at 628 ("Under accepted rules of statutory construction, it is generally presumed that Congress, in drafting legislation, is aware of well-established judicial construction of other pertinent existing statutes.") Moreover, that the language of section 523(a)(1)(C) is nearly identical to that used in section 7201 indicates that Congress was not only constructively but also actually aware of its I.R.C.

precedents when it drafted the bankruptcy provision.

"In determining the scope of section 7201, the Supreme Court has recognized that the statute "includes the offense of willfully attempting to evade or defeat the *assessment* of a tax as well as the offense of willfully attempting to evade or defeat the *payment* of a tax." *Sansone,* 380 U.S. at 354, 85 S.Ct. at 1011. Whereas section 7201 penalizes a taxpayer who either "willfully attempts in any manner to evade or defeat any tax imposed by this title *or the payment thereof,*" section 523(a)(1)(C) exempts from discharge only those taxes with respect to which the debtor "willfully attempted in any manner to evade or defeat such tax." The omission of the words "or the payment thereof" from section 523 (a)(1)(C), in light of Congress's previous inclusion of these words on four previous occasions, indicates that Congress did not intend that a failure to pay taxes, without more, should result in the nondischargeability of a debtor's tax liabilities in bankruptcy. *In re Gathwright,* 102 B.R. 211, 213 (Bankr. D.Or. 1989) (comparing section 523(a)(1)(C) to 26 U.S.C. §

> 7201 and concluding that failure to pay taxes does not constitute a willful attempt to evade or defeat a tax under section 523(a)(1)(C))." Id, 1516, 1517.

The Haas Court acknowledged "congressional recognition that honest debtors may fail to pay their properly acknowledged taxes. We must give effect to congress's decision to omit the words 'or payment thereof' in section 523(a)(1)(C) where it has shown itself capable of including such language." Id, 1518.

Thus, pursuant to Haas, the word "payment" is not to be read into 523(a)(1)(C), consequently Sumpter, on the facts in his case, cannot be summarily held to have wilfully attempted to evade or defeat a tax, when all that he did was to deed property to satisfy a preexisting and properly recorded mortgage that was

given for valuable and adequate consideration.

The standard should be made uniform throughout the circuits. What is the state of the law is "payment/collection" to be or not to be read into the act? How is Haas and Sumpter to be reconciled? Did Congress intend for §523 (a)(1)(C) to in some cases included the word "payment" or "collection" and some cases not. Such would not be a plausible state of the law.

Petitioner moves this Court to grant the Writ of Certiorari.

Dated: November 20, 1995

Jerry L. Sumpter, J.D.
Petitioner
P.O. Box 286
Cheboygan, Mich 49721
(616) 627-7167

NOT RECOMMENDED FOR PUBLICATION

Nos. 94-1439/94-1440

United States Court of Appeals
for the Sixth Circuit

In Re Jerry L. Sumpter
and Santina M. Sumpter,
Debtors

FILED Aug.22, 1995
Leonard Green, Clerk

United States of America,)
Plaintiff-Appellee)
)
v)ON APPEAL FROM
)UNITED STATES
Jerry L. Sumpter,)DISTRICT COURT
Defendant-appellant)FOR THE EASTERN
)DISTRICT OF
) MICHIGAN
Santina M. Sumpter,)
Defendant-appellant)
)

Before: MERRITT, Chief Circuit Judge; MARTIN, Circuit Judge; and BERTELSMAN, Chief District Judge.*

MERRITT, Chief Judge. This consolidated bankruptcy case involves the single issue of whether the debtors' tax liability should be

* The Honorable William O. Bertelsman, Chief Judge of the United States District Court for the Eastern District of Kentucky, sitting by designation.

excepted from discharge because they "wilfully evaded" payment of taxes by transferring real property to a trust for the benefit of their children. To answer this question we must interpret Section 523(a)(1)(C) of the Bankruptcy Code. 11 USC §523(a)(1)(C). Unlike most debts in a bankruptcy proceeding, Section 523(a)(1)(C) provides that a tax debt is nondischargeable if the debtor "made a fraudulent return or wilfully attempted in any manner to evade or defeat such tax." It is clear that filing a false return or taking affirmative steps to evade a tax renders the debt nondischargeable. The question here is whether the statute also covers conduct that avoids the payment of taxes known to the debtor to be owed. We affirm the Bankruptcy Court and the District Court's determination as to Mr. Sumpter that

his portion of the tax debt is not dischargeable in bankruptcy due to his willful attempt to evade payment of taxes by seeking to avoid attachment of assets. As to Mrs. Sumpter, however, we reverse the Bankruptcy Court and District Court and find that her portion of the tax debt is dischargeable because her actions were not "willful" under the statute.

FACTS

In 1979 Jerry and Santina Sumpter created a Trust naming their two children the sole beneficiaries. The terms of the Trust provided that it could not make loans to the settlors, Santina and Jerry Sumpter. The Trust has had three trustees since its inception, all neighbors, friends or relatives of the Sumpters with limited business experience. The Trust

accumulated its assets through its ownership of the building where Mr. Sumpter has his law practice, Sumpter & Perry, P.C. The Trust receives rent from Sumpter & Perry as well as from the other tenants in the building. The Trust has made numerous loans to Sumpter & Perry, P.C. over the years amounting to several hundred thousand dollars. These loans are documented and have always been paid back to the Trust by Sumpter & Perry, P.C.

In August, 1986, the IRS notified Jerry and Santina Sumpter of an assessment for joint and several tax liability for 1984 and 1985. A year later, the IRS notified the Sumpters of another assessment for tax years 1981 and 1982. In December 1987, the Sumpters received a second notice of tax delinquency from the IRS for years in question. Two weeks after receiving

the second notice, in January of 1988, the Sumpters received $90,000 from the Trust, which they used to pay debts incurred by Sumpter & Perry, P.C. This is the first time the Sumpters themselves, instead of the law firm, had received a loan directly from the Trust. (The terms of the Trust make it a violation for the Sumpters, but not for Sumpter & Perry, P.C., to receive a loan from the Trust.) As collateral for the loan from the Trust, the Sumpters gave the Trust a mortgage on six pieces of property they own. In April 1988, the IRS sent the Sumpters a final demand notice by registered mail.

On April 21, 1988, Mr. Sumpter met with an IRS agent who told him that the IRS was about to start collection proceedings against the Sumpters. On the same day, the Sumpters transferred ownership of the six pieces of property

to the Trust, thereby extinguishing the mortgage debt owed by the Sumpters to the Trust. On May 3, 1988, the IRS filed a notice of tax lien against the Sumpters.

In September 1989, the Sumpters filed a voluntary petition under Chapter 7 of the Bankruptcy Code seeking to discharge, among other debts, the debt owed to the IRS. Three months later, the United States brought a four-count adversary proceeding against each of the Sumpters individually to prevent discharge of their tax liability pursuant to 11 USC § 523(a)(1)(C), which prohibits wilfully evading or defeating payment of their federal taxes. The Bankruptcy Court granted summary judgment to the government as to Mr. Sumpter under Section 523(a)(1)(C) for wilful evasion of taxes and therefore did not reach

the other counts. The government's summary judgment motion as to Mrs. Sumpter was denied for all counts, including Section 523(a)(1)(C) and a trial was held. At trial, the Bankruptcy Court found that Mrs. Sumpter also wilfully evaded payment of federal taxes under Section 523(a)(1)(C) by fraudulently conveying property and held that her portion of the IRS debt could not be discharged. The District Court affirmed the Bankruptcy Court's findings in two separate opinions. (J.A. at 257 (Mrs. Sumpter), J.A. at 212 (Mr. Sumpter)) The Sumpters both appealed and their separate appeals were consolidated for review by this Court.

DISCUSSION

Standard of Review

We review the District Court's interpretation of the Bankruptcy Code

and its conclusions of law de novo. In re Perlin, 30 F. 3d 39, 40 (6th Cir. 1994). We review the Bankruptcy Court's factual determinations, in which the District Court concurred, under a "clearly erroneous" standard. Id.

Section 523(a)(1)(C)

A debtor under Chapter 7 of the Bankruptcy Code generally is granted a discharge from all debts that arise before the filing of the bankruptcy petition. 11 USC §727(b). Section 523, however, provides exceptions to discharge of certain debts. 11 USC § 523(a)(1)(C) provides in pertinent part:

> (a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt -
>
> (1) for a tax or customs duty --

. . . .

> (C) with respect to which the debtor made a fraudulent return willfully attempted in any manner to evade or defeat such tax; . . .

The sole issue in this case is whether the District Court was correct in affirming the Bankruptcy Court's conclusion that the Sumpters "wilfully" attempted to evade payment of their taxes in violation of Section 523(a)(1)(C). There is no dispute that returns were filed and that taxes are owed. The debtors made three arguments that their conduct does not fall within the statute. First, the debtors argue that their conduct of evading payment is not covered by the plain language of Section 523(a)(1)(C) because all they did was fail to pay the taxes owed.

They argue that they did not take an affirmative step to evade or defeat the tax. They contend that mere non-payment cannot be construed as wilful evasion under Section 523(a)(1)(C). Second, the debtors argue that because the property was already heavily mortgaged (albeit to a trust for the benefit of their children) and therefore of little cash value, the transfer did not affect the value of their estate and therefore the IRS did not lose anything by the transfer. Finally, the Sumpters also contend that the factual findings of the Bankruptcy Court were clearly erroneous and that the government failed to prove that they wilfully evaded payment of taxes. We will consider the Sumpters' arguments separately below.

As an initial matter, the debtors argue that the standard of proof for

applying the dischargeability exception under Section 523(a)(1)(C) is clear and convincing evidence of willful evasion, instead of the preponderance of the evidence standard used by the bankruptcy court. Although the Sixth Circuit has not directly ruled on this point, debtors appear to be wrong. In Grogan v. Garner, 498 U.S. 279, 284-86 (1991), the Supreme Court clearly stated that "the standard of proof for the dischargeability exceptions in 11 USC §523(a) is the ordinary preponderance of the evidence standard." Id at 292. Although Grogan concerned specifically Section 523(a)(2), not Section 523(a)(1)(C), the language used by the Supreme Court seems to encompass all of Section 523(a) and the other circuit courts and bankruptcy courts from this circuit interpreting Grogan have used the

preponderance of the evidence standard. See, e.g., In re Graham, 973 F.2d 1089, 1101 (3d Cir. 1991)("the text of [Grogan] consistently refers to section 523(a) in general"); Levinson v. United States, 969 F.2d 260 (7th Cir), cert. denied, 113 S. Ct 505 (1992); Goff v. IRS, 180 B.R. 193, *6(Bankr. W.D. Tenn. 1995)(unpublished); Ragone v. United States, 170 B.R. 324, 327 (Bankr. N.D. Ohio), aff'd, 179 B.R. 521 (N.D. Ohio 1994). Debtors have not cited any case to the contrary since Grogan was decided.

Mr. Sumpter

As to the Sumpters first argument, a recent Sixth Circuit case interpreting this part of Section 523 controls many aspects of this case. United States v. Toti, 24 F.3d 806 (6th Cir), cert. denied, 115 S. Ct 482 (1994). In Toti, this Court concluded

that a civil definition, not criminal, of willful should be applied to Section 523(a)(1)(C). The Court held that the proper definition of "willfully" under a Section 523(a)(1)(C) discharge case is like that found in other civil tax cases: voluntary, conscious and intentional. Id. at 809. Furthermore, the Court, after examining the unambiguous language of the statute and similar language in the tax code, found that the words "in any manner" are broad enough to encompass attempts to thwart payment of taxes. Id.; accord In re Bruner, 55 F. 3d 195 (5th Cir. 1995); Sells v United States, 92-1 U.S.T.C. (CCH) ¶ 50,070 (D. Colo. 1991); In re Jones, 116 B.R. 810 (Bankr. D. Kan. 1990). But see In Re Haas, 48 F. 3d 1153 (11th Cir. 1995) (finding that evading payment or collection is not a violation of §

523(a)(1)(C)); In re Gathwright, 102 B.R. 211 (Bankr. D. Or. 1989)(same).

There can be no question here that the Bankruptcy Court correctly found that Mr. Sumpter wilfully evaded paying his taxes. Mr. Sumpter admitted in his deposition that he attempted to thwart attachment of the federal tax liens by transferring property to the Trust:

> Q. (by the Government) Was the reason for transferring the properties to the trust to protect them from the Federal Tax Liens?
>
> A. (by Mr. Sumpter) I think the real reason was to discharge the mortgage and to provide what equity we could to discharge the mortgage for fear it would be -- a lien would be imposed against it and turn into a rat's nest.
>
> . . .
>
> Q. The question is "was one of the purposes or an additional purpose for transferring the properties to prevent the Federal Tax liens from attaching to the properties?"
>
> A. Yes.

Deposition of Jerry Sumpter at 50-51, J.A. at 713-14 (emphasis added). Given this admission, and in light of the recent holding by this Court in Toti, it seems clear that, as a matter of law, Mr. Sumpter "wilfully attempted . . . to evade or defeat" his taxes in violation of section 523(a)(1)(C). The only question is whether evading or defeating attachment of assets is included in the statutory language. Our conclusion in Toti that any affirmative step, including evading or defeating payment of taxes, is included in the statute and the fact that attachment is usually the first step taken by the IRS in attempting collection of the payment seems sufficient to include the admitted action by Mr. Sumpter of evading or defeating attachment.

We note that of the two cases that arguably support Mr. Sumpter's argument here, In re Gathwright and In re Haas, In re Gathwright has been rejected by the majority of the courts to address it. See, e.g., In re Fridrich, 156 B.R. 41 (D. Neb. 1993); In re Griffith, 161 B.R. 727, 733 (Bankr. S.D. Fla. 1993); In re Lewis, 151 B.R. 140 (Bankr. W.D. Tenn. 1992). The case recently decided by the Eleventh Circuit, In re Haas, is readily distinguishable from the facts here. In Haas, the debtor had timely filed his tax return, but like Mr. Sumpter, had never paid his taxes, choosing instead to pay certain business and personal debts. The Eleventh Circuit noted that if mere nonpayment of taxes would render the debt excepted from discharge, it would contravene the purpose of the Bankruptcy Code, which

is to allow a fresh start for the "honest but unfortunate" debtor. See Grogan v. Garner, 498 U.S. 279, 285 (1991). Mr. Haas took no affirmative steps to avoid paying his taxes, he simply did not pay them and continued to pay other debts. In contrast, Mr. Sumpter took the affirmative step of transferring property to avoid its attachment as a tax lien, an act to which he admits. By taking this affirmative step, Mr. Sumpter attempted to "wilfully evade or defeat" payment of his tax debt and he is excepted from discharge of that debt under Section 523(a)(1)(C).

In addition to the statutory interpretation argument made above, Mr. Sumpter also argues that certain facts make it impossible for his conduct to fall within the statute. It is true, as Mr. Sumpter argues, that

the transfer arguably did not affect the worth of the Sumpters' estate due to the mortgage on the transferred property. Mr. Sumpter argues that due to the mortgage on the property held by the Trust there was no value that the IRS could recover from the property even if it attached the lien. As there was arguably no monetary value that the IRS could recover, Mr. Sumpter asserts that there is no way he could be evading collection or payment of taxes. This argument is flawed, however, because the value of the property is not the touchstone. The issue is the conduct of the taxpayer. The timing and sequence of events here makes it arguable that the Sumpters specifically took the $90,000 loan from the Trust explicitly so they could make a "legitimate" transfer of the property to the Trust to avoid attachment of the

property. They had never taken a personal loan from the Trust before (all the loans had been to Mr. Sumpter's law practice), and, moreover, they were prohibited by the terms of the trust agreement from doing so. The loan was taken in January, 1988, right after they received the second delinquency notice from the IRS. Also, the transfer was to a Trust from which Mr. Sumpter's business took regular loans for operating expenses, including presumably Mr. Sumpter's salary. Indeed, the evidence showed that Mr. Sumpter, through Sumpter & Perry, had a great deal of control over the assets of the Trust and the Trust was regularly used to pay Sumpter & Perry expenses. Therefore, arguing that transfer of the property to the Trust did not affect the value of the estate is without much force because he has

shown by previous conduct that he often reaps business and personal benefit from the Trust monies.

In addition, had the IRS been able to attach the property when it was still mortgaged to the Trust it is unclear that the IRS would have had lower priority than the Trust/mortgagor to any proceeds from the sale of the property. Given these facts, we affirm the grant of summary judgment to the IRS against Mr. Sumpter.

Mrs. Sumpter

As to Mrs. Sumpter, the IRS argued that Mrs. Sumpter fraudulently transferred real estate to her children's trust to evade taxes she knowingly owed. She first contends, similar to Mr. Sumpter, that a fraudulent conveyance intended to thwart collection of taxes is not covered by Section 523(a)(1)(C). The

same legal arguments used against Mr. Sumpter, outlined above, also defeat Mrs. Sumpter's proposed construction of the statute. Because Mrs. Sumpter did not admit to attempting to avoid payment of taxes as did Mr. Sumpter, the government bore the burden at trial of proving that her actions were the type that satisfy the "wilful" language of the statute.

The IRS used a traditional "badges of fraud" inquiry to attempt to prove Mrs. Sumpter's intent wilfully to evade taxes through the transfer of property. Here the bankruptcy court found the following facts were badges of fraud supporting a finding of willful evasion: (1) the transfer was made to a family member as the Trust is held in favor the Sumpter's children; (2) the transfer was made at a time when a large liability, here a tax payment,

was fixed; (3) the transfer was for no consideration because the $90,000 loan received by the Sumpters in exchange for the mortgage went directly to Sumpter & Perry, P.C., a corporation in which Mrs. Sumpter has no direct financial interest. Mr. Sumpter, however, owns more than 99% of the stock of Sumpter & Perry, P.C.,; (4) the transfer was made when Mrs. Sumpter was insolvent, as the Sumpters had only $100-200 in their checking account when the transfer was made; (5) Mrs. Sumpter retained hidden control over the asset. The Sumpters apparently used the Trust as a conduit for payment of Sumpter & Perry's expenses, and, in turn, for their own personal expenses and (6) Mrs. Sumpter engaged in other questionable practices during the same period. Examples of these practices include the Sumpters receiving the

$90,000 loan from the Trust even though they were prohibited from receiving loans from the Trust under the Trust Agreement. Furthermore, all the other loans had been made directly from the Trust to Sumpter & Perry, not to the Sumpters directly. The government argued that the Sumpters made this loan to themselves so that they could then "legitimately" transfer the property to the Trust. United States v. Sumpter, 136 B.R. at 701 (J.A. at 487-96). The district court affirmed these findings. (J.A. at 265-72).

While some of these findings, standing alone, are not clearly erroneous, the ultimate conclusion that Mrs. Sumpter's actions and mental state were "willful" under the statute is not supported by the facts. Mrs. Sumpter was raised in Italy and has only a high school education. The Bankruptcy Court

found that she defers to her husband on most issues and has very little, if anything, to do with his business. Findings of Fact and Conclusions of Law (filed July 9, 1991) at 13. There is no evidence that she had any real control over the Trust assets when she signed the document to receive the loan from the Trust or that she understood that transfer to be any different from the earlier transfers. Mrs. Sumpter simply signed the document at the direction of her husband. Id. The transfer was, in effect, another business transaction by Mr. Sumpter of which Mrs. Sumpter had little knowledge or control.[1]

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[1] While not directly applicable here, the tax code provides some guidance in examining this issue. The standard under the "innocent spouse" exception, 26 U.S.C. § 6013(e)(1), is "whether a reasonable person under the circumstances of the taxpayer at the time of signing the [tax] return could be expected to know of the omissions."

The government does not dispute this but states that because she voluntarily signed over her property to the Trust and knew that she and her husband owed the IRS a considerable sum of money, her actions were "willful". Neither we nor the IRS want to encourage a spouse to turn a "blind eye" to the couple's tax situation and even minimal involvement in the family's financial affairs can be sufficient in some circumstances. In this case, however, where the conduct primarily concerned Mr. Sumpter's business affairs, which were fairly complex, Mrs. Sumpter's actions cannot be said to be "willful" under Section 523(a)(1)(C). On balance, the Bankruptcy Court and the District Court's conclusion that Mrs. Sumpter

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Shea v. Commissioner, 780 F. 2d 561, 566 (6th Cir. 1986).

"wilfully evaded" payment of taxes under Section 523(a)(1)(C) is in error and is reversed.

For the foregoing reasons, we AFFIRM the judgment as to Mr. Sumpter and REVERSE the judgment as to Mrs. Sumpter.

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MICHIGAN
NORTHERN DIVISION

In Re:
Jerry L. Sumpter,
Debtor / Filed 3/10/94
United States of America,
Plaintiff/appellee
v. Case No.
Jerry L. Sumpter, 91-CV-10231-BC
Defendant/appellant/

MEMORANDUM OPINION AND ORDER AFFIRMING BANKRUPTCY COURT

I. Introduction

This case is before the Court on Jerry Sumpter's appeal from the bankruptcy court's determination, on summary judgment, that his liabilities owed to the Internal Revenue Service were nondischargeable pursuant to 11 U.S.C. §523(a)(1)(C) and that, therefore, these liabilities should be excepted from the discharge issued under 11 U.S.C. §727(a). For the reasons stated herein, the judgment is affirmed.

II. PROCEDURAL POSTURE

On September 27, 1989, Jerry and Santina M. Sumpter filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. In addition to seeking discharge of various debts, they also sought discharge of a debt to the Internal Revenue Service sought discharge of a debt to the Internal Revenue Service ("I.R.S.") for unpaid income taxes, interest and penalties. In December of 1989, the Government brought a four-count complaint against the Sumpters seeking (1) a denial of discharge pursuant to Bankruptcy Code §727(a)(4), (a)(2), and (a)(5)(Counts I-III) and (2) a determination pursuant to Bankruptcy Code §523(a)(1)(C) that their federal income tax liabilities are not dischargeable (Count IV). Cross motions for summary judgment were filed on all counts in September 1990.

On December 6, 1990 the bankruptcy court dismissed Count II against the Sumpters and denied the I.R.S.'s motions for summary judgment against Santina Sumpter on all counts. However, the Court granted the I.R.S.'s motion on Count IV (§523(a)(1)(C)) against Jerry Sumpter, declaring that the I.R.S. debt was not dischargeable. Thereafter, Jerry Sumpter timely filed a motion for reconsideration of the court's order. In July of 1991, after the bankruptcy court's denial of his motion for reconsideration, Jerry Sumpter filed notices of appeal in this Court.[1]

On November 7, 1991, having never received a transmittal of the record on

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[1] Apparently, due to confusion as to whether his attorney had in fact filed a notice of appeal, appellant filed his own notice of appeal (number 91-10231 was filed by attorney Donald Cadotte; number 91-10235 was filed by Jerry Sumpter, who is a licensed attorney).

appeal, this Court dismissed without prejudice Jerry Sumpter's previously filed appeals (civil case numbers 91-CV-10231, 10235). Subsequently, Jerry Sumpter moved for this Court to reinstate these appeals. The motion was ultimately granted and an order was issued on September 30, 1993, reinstating these appeals under a singular case number (91-CV-10231-BC). This sole appeal is now before the Court.[2]

III. FACTS

In late 1970, the Sumpters created trusts naming their two children as the

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[2] The issue of the dischargeability of Santina Sumpter's debt to the I.R.S. was presented before the bankruptcy court in a trial on the merits in March, 1991. The bankruptcy court determined that, pursuant to §523(a)(1)(C) of the Bankruptcy Code, Mrs. Sumpter's debt did not qualify for discharge. *See United States v. Sumpter,* 136 BR 690 (Bankr. E.D. Mich. 1991). Judgment was entered on July 9, 1991. Santina Sumpter's appeal of this decision was affirmed by this Court in a separate order.

sole beneficiaries. (TR 27-28)[3] The trust document that created both of the trusts provided that the trustees could not make loans from the trust to the settlors, Mr. and Mrs. Sumpter. Three different trustees have served during the life of the trusts. All three have been either family, friends or neighbors of Mr. and Mrs. Sumpter. (TR 156-59). The trusts have assets totalling over $190,000.[4] The only explanation given as to how the trusts accumulated these assets was that the trusts own the building in which Mr. Sumpter's law firm or professional corporation ("P.C.") is located and

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[3] "TR" refers to the transcript of Santina Sumpter's trial, located at Record 2 ("R").

[4] Relying on trial exhibit 4 (the Sumpters' Statement of Financial Condition, which was signed by the Sumpters), the bankruptcy court found that, as of My 6, 1988, the value of the trust was $190,000. This exhibit, while not included in the designated documents, is not objected to by either party.

that the P.C. pays rent to the trusts. (TR 165). From the creation of the trusts until the time of the trial in this matter, Mr. Sumpter's P.C., of which he owns virtually all of the stock, received 12 loans from the trusts totalling $257,900.

On August 25, 1986, the I.R.S. made an assessment for joint and several income tax liabilities against Mr. and Mrs. Sumpter [5] for tax year 1985. Thereafter, additional assessments were made against the Sumpters. On December 8, 1986 an assessment was made for tax year 1984 and on August 19, 1987 an assessment was made for tax years 1981 and 1982. By notices and demands dated the dates of each of the assessments, the

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[5] As stated, Mrs. Sumpter's liabilities are not at issue in this appeal.

Sumpters were notified of said assessments. (TR-83-88).

On January 12, 1988, within a short time after second notices of the federal tax liabilities were sent by the I.R.S. (notices were sent December 21, and 28, 1987; Tr 86) a mortgage (R.23) was filed (TR 40, 133) with respect to six parcels of property owned by the Sumpters, naming the childrens' trusts as the mortgagees and the Sumpters as mortgagors. In exchange for the mortgage on the six pieces of real property, the trust loaned the Sumpters $90,000. On April 7, 1988, the I.R.S. sent by certified mail, return receipt requested, a final demand for payment to Mr. and Mrs. Sumpter (Tr 86-88). Mrs. Sumpter signed the green card noting receipt of such notice on April 12, 1988. (Tr 87). On April 23, nine days after receiving

this notice, Mr. and Mrs. Sumpter transferred (i.e. deeded) the six parcels of property to the trusts. (TR 25-37, 133).[6] On April 26, 1988, the trust agreement that allegedly created the trusts in the late 1970's was recorded for the first time (TR 34-40).

At her trial, Mrs. Sumpter testified that $40,000 of this was used to pay off a loan that was previously secured to fund Mrs. Sumpter's business (TR 137); $12,000 went to pay off an undocumented loan from an employee of the P.C. (Tr 150); and the remaining $38,000 was transferred to the P.C. (TR 137). There is no evidence that any promissory note was ever issued by the P.C. to Mr. or Mrs. Sumpter for the moneys they gave the P.C. At this

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[6] The properties were conveyed to the trust in payment of the indebtedness secured by the mortgages -- in essence, deeds in lieu of foreclosure.

time, the Sumpters' liabilities were in excess of their assets. Additionally, the Sumpters had only one personal bank account with an average balance of $100 - $200 "... for groceries and stuff ... " and no other visible means of support. (TR 153-54).

IV. ISSUES

1) Whether the bankruptcy court erred in holding that even fraudulent transfers intended to thwart the government's collection actions can constitute an attempt to "evade or defeat" a tax under 11 U.S.C. §523(a)(1)(C).

2) Whether the bankruptcy court erred in finding that, as a matter of law, the tax liabilities of Jerry Sumpter are nondischargeable under 11 USC §523(a)(1)(C) due to his willful attempt to evade or defeat such liabilities.

V. STANDARD OF REVIEW

On review of an order granting summary judgment the appellate court applies the same standard as the trial court. Under Fed. R. Civ. P. 56, summary judgment should be entered only when there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. "Where the moving party has carried its burden of showing that the pleadings, depositions, answers to interrogatories, admissions and affidavits in the record construed favorable to the non-moving party, do not raise a genuine issue of material fact for trial, entry of summary judgment is appropriate." Gutierrez v. Lynch, 826 F. 2d 1534, 1536 (6th Cir. 1987), citing, Celotex Corp. v Catrett, 477 U.S. 317 (1986). Furthermore, summary judgment is not appropriate

when "the evidence presents a sufficient disagreement to require submission to a jury." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 251-52 (1986). The existence of some factual dispute does not defeat a properly supported motion for summary judgment; it is required that there be no genuine issue of material fact. The burden placed upon the movant for summary judgment is to show that the non-moving party has failed to establish an essential element of his case upon which he would bear the ultimate burden of proof at trial. Celotex Corp v. Catrett, 477 U.S. at 322. The non-moving party must show that there is doubt as to the material facts and that the record, taken as a whole, does not lead to a judgment for the movant. Street v. J.C. Bradford & Co., 886 F. 2d 1472 (6th Cir. 1989).

The non-moving party must show that there is sufficient evidence for a jury to return a verdict in its favor. Street at 1476. The non-moving party must also present affirmative evidence on critical issues. Street, at 1477. When the moving party has carried its burden under Rule 56(c), its opponent must do more than simply show that there is some metaphysical doubt as to the material facts. Matsushita Electric Industrial Co. v. Zenith Radio Corp., 475 U.S. 574 (1986). Thus, it is this Court's role to "pierce the pleadings and to assess the proof in order to see whether there is a genuine need for trial." Id at 587.

VI. DISCUSSION-

11 U.S.C. §523(a)(1)(C) provides in pertinent part:

§523 Exceptions to discharge

> (a) A discharge under section 727 ... of this title does not discharge an individual debtor from any debt -
>
> (1) for a tax or customs duty -
>
> . . .
>
> (C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

Id. (emphasis added). A party seeking an exception to the bankruptcy discharge of the debtor (i.e., the government) must establish the elements for such an exception by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 287-88 (1991).

A. FRAUDULENT TRANSFERS

In its motion, the government argued, inter alia, that Mr. Sumpter attempted to evade or defeat taxes he owed under §523(a)(1)(C) by fraudulently conveying real estate to his children's trust before the I.R.S.

could levy on the property. On appeal Mr. Sumpter contends that even allegedly fraudulently transfers intended to thwart the government's collection actions do not constitute an attempt to "evade or defeat" the tax under §523(a)(1)(C). In support of this argument, appellant relies on In Re Gathwright, 102 B.R. 211 (Bankr D.Or. 1989), where the court held that §523(a)(1)(C) did not apply to willful attempts to evade or defeat the collection of taxes. In Gathwright, the court stated that:

> "Under §7201(a), which provides that it is a felony to 'wilfully attempt [] in any manner to evade or defeat any tax imposed by [Title 26] or the payment thereof,' the IRS must prove a willful and positive attempt to evade or defeat tax ... Although sections 523 (a)(1)(C) makes nondischargeable tax liabilities which the debtor has willfully attempted to evade or defeat, it does not include willful attempts to evade or defeat 'payment' as

> a basis for nondischargeability ... [B]ecause the Bankruptcy Code exception to discharge lacks the language 'or the payment thereof,' evidence regarding any willful attempt to evade or defeat payment of the tax is not relevant to a determination of nondischargeability. Consequently, I will disregard evidence presented by the IRS regarding debtor's alleged attempt to frustrate collection of the taxes at issue in this case.

Id. at 213. The bankruptcy court in the instant case, relying on In re Jones, 116 B.R. 810,815 (Bankr. D. Kan. 1990), rejected the Gathwright court's holding. (R.3, Transcript of summary judgment hearing, p.62). As the Jones court noted, if §523(a)(1)(C) is construed to mean that only debtors who commit affirmative acts of tax evasion (e.g. filing a fraudulent tax return or keeping two sets of books) are disqualified from discharge, then debtors who elude taxes through acts of

omission would be left with a "lucrative device" for avoiding payment. Id. at 815. It is not likely that the framers of the Bankruptcy Code intended such a result.

This court has recently concluded that a civil case (and not a criminal) definition of "willfully" must be applied to §523(a)(1)(C). In United States v. Toti, 149 BR 829 (E.D. Mich. 1993), the court rejected the suggestion that §523(a)(1)(C) should be interpreted in a manner consistent with §7201. The court instead held that "the proper definition of 'willfully attempted to evade' in the context of an 11 U.S.C. §523(a)(1)(C) discharge case is that found in other civil tax cases -- voluntary, conscious and intentional." Id at 834. Other courts have reached the same conclusion. See e.g., United States v Hedgecock, 160

B.R. 380 (D.Or. 1993); Berzon v. United States, 145 B.R. 247 (Bankr N.D. Ill. 1992); Sells v. U.S., 92-1 U.S.T.C. CCH ¶ 50,070 (D.Col. 1991). These cases are persuasive as they adopt a plain reading of an unambiguous statute. Thus the court holds that §523(a)(1)(C)'s modifying phrase "in any manner" is expansive enough to include evading or defeating collection or payment of a tax. In re Jones, 116 B.R. 810, 815 (Bankr. D. Kan. 1990). Accordingly, if proved, the transfers in the instant case -- allegedly intended to thwart the government's collection of taxes owed -- would constitute a willful attempt to evade or defeat such taxes under §523(a)(1)(C).

B. 11 U.S.C. §523(a)(1)(C)

The government, in its attempt to show a willful attempt to evade or

defeat taxes owed, relied on appellant's own deposition testimony. The specific exchange relied on by the bankruptcy court is as follows:

> Q. (by the government) Was the reason for transferring the properties to the trust to protect them from the Federal Tax liens?
>
> A. (by appellant) I think the real reason was to discharge the mortgage and to provide what equity we could to discharge the mortgage for fear that it would be -- a lien would be imposed against it and turn into a rats nest.
>
> Q. So what was -- well, was that something that you considered or thought of at the time that you were transferring the property and that is well, I could pay off this mortgage and in addition to that I could keep the liens from attaching to the properties?
>
> A. I couldn't pay off the mortgage. I had no money. The only way I could pay off the mortgage was with the equity in the property.
>
> Q. The question is was one of the purposes or an additional purpose for transferring the properties to prevent the

Federal Tax liens from attaching to the properties.

A. Yes.

R. 5, deposition of Jerry Sumpter, p50-51 (emphasis added). Based on this testimony, the bankruptcy court determined that appellant willfully attempted to evade or defeat a tax under §523(a)(1)(C). R.3, hearing on motion for summary judgment, pp 66-67. The court's reasoning was as follows:

> ". . . willfully attempted [under §523(a)(1)(C)] obviously includes some kind of mental state. It's not -- it doesn't say did an act which in retrospect look what it caused. [Or that the debtor] did in fact evade a tax or defeated a payment of the tax. The question is what was the debtor's intent. Willful means intentional. Intentionally attempted to evade or defeat the tax.
>
> The debtor answers that question yes. One of the reasons I did this deed was to defeat the tax. Therefore the Government's motion for summary judgment on [the §523(a)(1)(C) Count] is granted as to Jerry Sumpter.

Id. (emphasis added) Appellant argues that the bankruptcy court erred because it failed to consider the value of the properties that he (along with his wife) transferred to the trust. If the value of the properties did not exceed the amount of the mortgage the I.R.S., according to appellant, "lost nothing in the conveyance." Appellant's Brief 8. Appellant further maintains that if this were in fact the case (or, alternatively, if he reasonably believed it to be the case), that his transfer -- which admittedly was effected with an intent to avoid the tax lien -- was somehow not committed with an intent to evade or defeat the tax. Appellant's Brief 8. Appellant cites no authority in support of this unique construction of what appears on its face to be an ambiguous statute.

The Court rejects appellant's argument as it is spurious. As stated, §523(a)(1)(C) provides for an exception to discharge if the debtor "willfully attempted in any manner to evade or defeat" a tax. this provision does not require, as appellant suggests, that an attempt to evade or defeat a tax to be successful; but only that it was "willful". Although the word "attempt" is not defined by the Bankruptcy Code, in the non-criminal context it generally means an intent combined with an act falling short of the thing intended. Black's Law Dictionary (Sixth Ed. 1990). Moreover, even in the criminal context, appellant's argument of "factual impossibility" would be without merit. In the criminal law, factual impossibility denotes conduct where the objective is illegal but a circumstance unknown to

the actor prevents him from bringing it about. United States v. Conway, 507 F. 2d 1047, 1050 (5th Cir. 1975). The classic example is the thief who picks an empty pocket. Id. However, "factual impossibility may fall away as a defense to an attempt charge when adequate proof of intent to commit a specific crime exists." United States v. Johnson, 767 F. 2d 673, 675 (10th Cir. 1985).

In the instant case, the statute requires only that the government prove that appellant "willfully attempted in any manner to evade or defeat" the taxes he owed. §523(a)(1)(C). Appellant concedes that his purpose in transferring the properties to the trust was to prevent the Federal Tax liens from attaching to the properties. This evidence supports the finding that, irrespective of the value of the

properties that were transferred, appellant willfully attempted to evade or defeat taxes he owed under §523(a)(1)(C). Accordingly, summary judgment on this count was proper.

VII. CONCLUSION

The bankruptcy court determined that, as a matter of law, appellant had willfully attempted to evade or defeat taxes he owed when he (along with his wife) transferred properties to his children's trust. 11 U.S.C. §523(a)(1)(C). For the aforementioned reasons, this Court holds that the summary judgment was proper. Accordingly, the bankruptcy court's decision is affirmed.

IT IS SO ORDERED.

Dated: March 9, 1994

/s/ Robert H. Cleland
United States District Judge

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF MICHIGAN
NORTHERN DIVISION

IN re:
JERRY & SANTINA SUMPTER,
Debtor

Case No. 89-09791

UNITED STATES OF AMERICA,
Plaintiff

v A.P. No. 89-9090

JERRY & SANTINA SUMPTER,
Defendants

ORDER GRANTING PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT ON COUNT 4 AS TO DEFENDANT JERRY SUMPTER

For the reasons stated from the bench,

IT IS HEREBY ORDERED that the Plaintiff's motion for summary judgment on Count 4 is GRANTED as against Defendant Jerry Sumpter, but DENIED as against Defendant Santina Sumpter.

Dated: December 6, 1990

/s/ ARTHUR J. SPECTOR
U.S. Bankruptcy Judge

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No. 95-1162

In the Supreme Court of the United States

OCTOBER TERM, 1995

JERRY L. SUMPTER, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

DREW S. DAYS, III
Solicitor General

LORETTA C. ARGRETT
Assistant Attorney General

GARY D. GRAY
LAURIE SNYDER
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 514-2217

12 pp

QUESTION PRESENTED

Whether a debtor's affirmative acts to thwart the collection of his delinquent federal income taxes constitute a willful attempt to evade or defeat such taxes within the meaning of Section 523(a)(1)(C) of the Bankruptcy Code, 11 U.S.C. 523(a)(1)(C).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-26) is unpublished, but the decision is noted at 64 F.3d 663 (Table). The opinion of the district court (Pet. App. 27-49) is reported at 170 B.R. 908. The opinion of the bankruptcy court (Pet. App. 50) is reported at 136 B.R. 690.

JURISDICTION

The judgment of the court of appeals was entered on August 22, 1995. The petition for a writ of certiorari was filed on November 20, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In 1979, petitioner created a trust for the benefit of his children. Other family members and friends were designated as trustees (Pet. App. 3). Sumpter & Perry, P.C., of which petitioner owns nearly all the stock, leases its office space and regularly borrows money from the trust (Pet. 2; Pet. App. 3-4, 32). By its terms, however, the trust is prohibited from lending money directly to petitioner. Prior to January 1988, petitioner had never borrowed from the trust (*id.* at 5).

In August 1986, the Internal Revenue Service notified petitioner of assessments for income taxes due from him for the years 1984 and 1985. A demand for payment of those taxes was also made at that time. In August 1987, the Service made assessment and demand for payment of the taxes due from petitioner for the years 1981 and 1982 (Pet. App. 4). Additional notices and demands for payment were sent to petitioner in December 1987 (*ibid.*). Two weeks after receiving these last notices, petitioner and his wife gave mortgages of their property to the trust to secure a $90,000 loan that the trust made to them at that time (*id.* at 3, 4-5).

On April 21, 1988, an IRS agent informed petitioner that the IRS would soon file notices of tax liens with the local registry of deeds (Pet. App. 5). Later that same day, petitioner transferred title to the mortgaged properties to the trust and the trust cancelled the underlying debt (*id.* at 5-6). Less than two weeks later, the Service filed its notices of tax lien (*id.* at 6).

2. In 1989, petitioner filed for relief under Chapter 7 of the Bankruptcy Code and sought a discharge of his federal tax debts (Pet. App. 6). The government

brought an adversary proceeding, claiming that petitioner's tax liabilities were nondischargeable under Section 523(a)(1)(C) of the Bankruptcy Code, which provides that a debtor is not discharged from a tax debt if he "willfully attempted in any manner to evade or defeat such tax" (11 U.S.C. 523(a)(1)(C)).

Petitioner admitted that one of his reasons for transferring the properties to the trust in April 1988 was to avoid the effect of the federal tax liens on the properties (Pet. App. 14, 44-45). He contended, however, that Section 523(a)(1)(C) does not apply to attempts to evade or defeat the *collection* of a tax liability, but only to attempts to evade or defeat the *determination* of the underlying tax liability (Pet. App. 9-10, 40-41). The bankruptcy court rejected petitioner's interpretation of the statute and granted summary judgment in favor of the government (*id.* at 28-29, 50).

3. The district court affirmed (Pet. App. 27-49). The court held that "§523(a)(1)(C)'s modifying phrase 'in any manner' is expansive enough to include evading or defeating *collection or payment of* a tax" (*id.* at 43). The court rejected as "spurious" petitioner's suggestion that his intent to avoid the tax liens by transferring properties to the trust was not evidence of an intent to evade or defeat taxes without proof that he had equity in the properties (*id.* at 46-49). The court held that Section 523(a)(1)(C) did not require that the attempt to evade or defeat the tax obligation be successful, only that it be willful (Pet. App. 47).

4. The court of appeals affirmed (Pet. App. 1-26). The court interpreted the words "in any manner" in Section 523(a)(1)(C) "to encompass attempts to thwart payment of taxes" (Pet. App. 12-13). Noting that the

attachment of a federal tax lien to assets "is usually the first step taken by the IRS" to enforce payment of a tax, the court held that petitioner's admitted attempt to evade the effect of these liens was sufficient to trigger the exception to dischargeability of Section 523(a)(1)(C) (Pet. App. 15). Noting that petitioner had admitted that he had transferred the property in part to avoid the federal tax liens, the court held that petitioner had attempted to evade or defeat collection of the taxes within the meaning of the nondischargeability statute (*id.* at 17-20).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Under Section 727 of the Bankruptcy Code, a debtor in a Chapter 7 case is generally discharged from all debts that arose before the filing of the bankruptcy petition. 11 U.S.C. 727(b). Under Section 523(a)(1)(C) of the Code, however, an individual debtor is not discharged "from any debt * * * for a tax * * * with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax." 11 U.S.C. 523(a)(1)(C). This case does not involve a fraudulent return; it involves only the second clause of Section 523(a)(1)(C), which denies discharge when there has been a "willful[] attempt[] in any manner to evade or defeat such tax."

The language of Section 523 is straightforward. Congress did not provide any specialized definitions for its terms. The words are therefore to be interpreted with their ordinary, everyday meaning. See

Commissioner v. *Soliman*, 506 U.S. 168, 174 (1993); *Malat* v. *Riddell*, 383 U.S. 569, 571 (1966) (per curiam).[1]

a. The court of appeals concluded that the broad phrase used in Section 523(a)(1)(C) — "in any manner to evade or defeat such tax" — encompasses not only a debtor's attempt to evade or defeat the assessment of a tax but also a debtor's attempt to evade or defeat the payment or collection of a tax already assessed by concealing or transferring his property in an effort to avoid the effect of the tax lien (Pet. App. 12-17). That same interpretation of the statute has been applied in several recent decisions. See, *e.g.*, *Dalton* v. *IRS*, 77 F.3d 1297 (10th Cir. 1996) (tax debts nondischargeable under Section 523(a)(1)(C) because debtor attempted to conceal assets from IRS by placing them in his wife's name); *In re Bruner*, 55 F.3d 195 (5th Cir. 1995) (tax debts nondischargeable under Section 523(a)(1)(C) because debtor attempted to conceal assets from IRS and engaged in pattern of non-payment and non-filing). As the court stated in *Dalton* v. *IRS*, *supra*, the statutory phrase "in any manner" is "sufficiently broad to include willful attempts to evade taxes by concealing assets to protect them from execution or attachment." 77 F.3d at 1301.

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[1] Petitioner does not contend that the word "willfully" as it appears in Section 523(a)(1)(C) requires a criminal state of mind or that the government must prove the elements of criminal tax evasion in order to satisfy the discharge exception. Courts have consistently interpreted the term "willful" in civil tax statutes to mean voluntary, conscious or intentional. *In re Toti*, 24 F.3d 806 (6th Cir.), cert. denied, 115 S. Ct. 482 (1994). See, *e.g.*, *Domanus* v. *United States*, 961 F.2d 1323, 1326 (7th Cir. 1992); *Collins* v. *United States*, 848 F.2d 740, 742 (6th Cir. 1988).

The common meaning of the word "evade"—in connection with tax obligations—is "to fail to pay or to minimize (taxes) in violation of law." *Webster's Third New International Dictionary* 786 (1986). See also *Black's Law Dictionary* 554 (6th ed. 1990). The common definition of the word defeat—in connection with a legal obligation—is "[t]o prevent, frustrate, or circumvent; as in the phrase 'hinder, delay, or defeat creditors'" (*id.* at 418). Applying the ordinary meaning of these statutory terms, the court of appeals correctly held in this case that petitioner's attempt to thwart efforts to collect his tax liabilities by transferring his properties for the admitted purpose of frustrating the effectiveness of the federal tax liens was a willful attempt "in any manner to evade or defeat" his tax liability (Pet. App. 12-17). Through these affirmative acts, petitioner attempted to frustrate and defeat the collection of the tax.

2. Petitioner errs in asserting (Pet. 1) that *In re Toti*, 24 F.3d 806 (6th Cir.), cert. denied, 115 S. Ct. 482 (1994)—on which the court of appeals relied in this case (Pet. App. 12-13)—is in conflict with *In re Haas*, 48 F.3d 1153 (11th Cir. 1995). In *Toti*, the debtor sought a discharge for taxes after he had knowingly failed to file his tax returns and pay the taxes due. The debtor argued in *Toti* that Section 523(a)(1)(C) of the Bankruptcy Code prohibits discharge only when the debtor has committed an affirmative act that would be felonious under 26 U.S.C. 7201 (willful attempt to evade or defeat tax) and does not prohibit discharge for acts of omission that would constitute misdemeanors under 26 U.S.C. 7203 (willful failure to file return or pay tax). The court of appeals disagreed, holding that Section 523(a)(1)(C) includes both acts of commission and acts of omission. 24 F.3d at

809. The court concluded that where a debtor knowingly fails to file returns and pay taxes, the taxes are nondischargeable in bankruptcy. *Ibid.*

Haas involved a different situation. In *Haas*, the debtor simply failed to pay his tax liability. Unlike the debtor in *Toti*, the debtor in *Haas* had properly filed his returns and reported his taxes. In that context, the Eleventh Circuit held in *Haas* that "a debtor's failure to pay his taxes, alone, does not fall within the scope of section 523(a)(1)(C)'s exception to discharge in bankruptcy." 48 F.3d at 1158. The court noted in *Haas* that Section 523(a)(1)(C) of the Bankruptcy Code, unlike 26 U.S.C. 7201, does not include the phrase "or the payment thereof."[2] The court reasoned that the passive act of failing to pay is therefore not sufficient by itself to prevent discharge. 48 F.3d at 1156, 1157.

The question whether a mere omission to pay an outstanding tax would, by itself, prohibit discharge was not addressed either in this case or in *Toti*. Neither this case nor *Toti* involved "mere nonpayment." Petitioner did not simply fail to pay his taxes;

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[2] See also 26 U.S.C. 6531(2) (establishing period of limitation on criminal prosecution of various offenses arising under Internal Revenue Code, including "the offense of willfully attempting in any manner to evade or defeat any tax *or the payment thereof*" (emphasis added)); 26 U.S.C. 6653 (imposing penalty upon any person who "willfully attempts in any manner to evade or defeat any such tax *or the payment thereof*" (emphasis added)); 26 U.S.C. 6672 (imposing civil penalty on person who "willfully attempts in any manner to evade or defeat any such tax *or the payment thereof*" (emphasis added)); 26 U.S.C. 7201 (making guilty of felony person who "willfully attempts in any manner to evade or defeat any tax imposed by this title *or the payment thereof*" (emphasis added)).

he also acted affirmatively to defeat collection by transferring property in an effort to shield it from the federal tax liens.[3]

Under circumstances similar to those in this case —failure to pay combined with an affirmative act to prevent collection—the Tenth Circuit recently agreed with *Haas* that mere failure to pay alone does not prevent discharge. *Dalton* v. *IRS*, 77 F.3d at 1301. The court in *Dalton* also agreed with the court here, however, that when a failure to pay is accompanied by an affirmative act to evade or defeat collection, Section 523(a)(1)(C) applies to prevent discharge. 77 F.3d 1300-1301. In applying Section 523(a)(1)(C) to a spectrum of misconduct, the courts of appeals have thus reached consistent, not conflicting, decisions. See *Dalton* v. *IRS*, *supra*; *In re Bruner*, *supra*; *In re Haas*, *supra*; *In re Toti*, *supra*.

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[3] Contrary to petitioner's contention (Pet. 11-19), the court of appeals did not base its conclusion that he had attempted to evade or defeat his taxes solely on the finding that he had transferred properties to the trust for the admitted purpose of avoiding the tax lien—although that would have been sufficient. The court also relied on other undisputed facts and permissible inferences concerning the entire sequence of events culminating in the transfer in reaching that conclusion (Pet. App. 18-20).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

LORETTA C. ARGRETT
Assistant Attorney General

GARY D. GRAY
LAURIE SNYDER
Attorneys

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